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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
DOCKET CONTROL

COMMISSIONERS

KRISTIN K. MAYES - Chairman

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BOB STUMP

IN THE MATTER OF THE APPLICATION OF
UNS ELECTRIC, INC. FOR THE
ESTABLISHMENT OF JUST AND REASONABLE
RATES AND CHARGES DESIGNED TO
REALIZE A REASONABLE RATE OF RETURN
ON THE FAIR VALUE OF THE PROPERTIES OF
UNS ELECTRIC, INC. DEVOTED TO ITS
OPERATIONS THROUGHOUT THE STATE OF
ARIZONA.

DOCKET NO. E-04204A-09-0206

STAFF'S OPENING BRIEF

I. INTRODUCTION.

UNS Electric, Inc. ("UNSE" or "Company") is a public utility serving approximately 90,000 electric customers in Arizona.¹ UNSE and UNS Gas are both subsidiaries of UniSource Energy Services ("UES").² The stock of UES is held by UniSource Energy Corporation, a holding company, whose principal subsidiary is Tucson Electric Power Company ("TEP"), the second largest investor-owned generation and distribution utility in Arizona.³

The Company is requesting a rate increase of \$13,500,000 over its adjusted Test Year revenues of \$160,926,065, for a revenue requirement of \$174,426,065.⁴ The Company's proposal results in an operating income of \$18,097,196 or 10.30% rate of return on its proposed Original Cost Rate Base ("OCRB") of \$175,818,913.⁵ Staff recommends a \$7,830,901 increase in revenue requirement over test year revenues.⁶ Staff's recommended revenue requirement results in an operating income of \$14,160,285 or a rate of return of 8.40% over Staff adjusted OCRB of

Arizona Corporation Commission

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¹ Ex. S-9 (Fish Direct) at 2: 23-24.

² Ex. S-14 (Parcell Direct) at 15:10-11.

³ Ex. S-14 (Parcell Direct) at 15:14-16.

⁴ Staff Final Schedule THF A-1.

⁵ UNSE Final Schedule A-1.

⁶ Staff Final Schedule THF A-1.

1 \$168,574,818.⁷ Staff's recommended rate design was developed to recover Staff's recommended
2 revenue requirement.⁸

3 Staff, like in the previous UNSE rate case, opposes inclusion of the Black Mountain
4 Generating Station ("BMGS") in rate base at this time because the Company did not own BMGS
5 during the test year, and the plant costs are not known and measurable.⁹

6 Staff presented five witnesses in this case. Dr. Thomas H. Fish provided testimony
7 addressing revenue requirement and certain adjustments to operating expenses; Original Cost Rate
8 Base ("OCRB"); Reconstruction Cost New Depreciation ("RCND"); Fair Value Rate Base
9 ("FVRB"); Purchased Power and Fuel Adjustment Clause ("PPFAC"); review of the Black Mountain
10 Generating Station ("BMGS"); review of affiliate transactions between the Company, UniSource
11 Energy, and its other affiliates; analysis of the appropriateness of the proposed depreciation
12 schedules; and a prudence review of fuel and purchased power policy.¹⁰ David Parcell provided
13 testimony regarding Staff's cost of capital recommendations evaluating the cost of capital for UNSE
14 as well as UniSource Energy Corporation.¹¹ W. Michael Lewis evaluated and provided testimony
15 regarding quality of service and distribution system reliability, major investment items proposed for
16 post test year inclusion into rate base, comparative standards of construction between the acquired
17 system and subsequent installations, and the construction quality of the BMGS.¹² Kenneth Rozen
18 provided Staff testimony and analysis regarding UNSE's proposed revisions to its rules and
19 regulations as discussed in Thomas A. McKenna's direct testimony. Lastly, William Stewart
20 provided Staff testimony regarding cost of service ("COS") and rate design recommendations.¹³

21 Administrative Law Judge Farmer conducted hearings on the Company's rate application on
22 February 4, 2010 through February 11, 2010.

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26 ⁷ Staff Final Schedule A-1.

27 ⁸ Ex. S-12 (Stewart Direct) at 3:6-8.

28 ⁹ Ex. S-9 (Fish Direct) at 55: 1-3.

¹⁰ Ex. S-9 (Fish Direct) at 2:6-13.

¹¹ Ex. S-14 (Parcell Direct) at 1:18-23.

¹² Ex. S-7 (Lewis Direct) at 2:11-17.

¹³ Ex. S-12 (Stewart Direct) at 2:22-24.

1 **II. REVENUE REQUIREMENT / OPERATING INCOME.**

2 The Company proposes a base rate increase of \$13,500,000 over its adjusted test year
3 revenues.¹⁴ Staff's analysis indicates that the Company's proposed rate increase is overstated and not
4 supported by the facts in this proceeding. Staff witness Dr. Fish has established that a base rate
5 increase of \$7,830,901 is appropriate for the Company.¹⁵

6 **A. Rate Base.**

7 The Company is proposing an original cost rate base of \$175,688,714.¹⁶ Staff is
8 recommending an adjusted original cost rate base of \$168,574,818.¹⁷ The main disagreement
9 between the parties to this case is the Company's proposed inclusion of non-revenue producing post-
10 test year plant and the BMGS in rate base, as well as the Company's request for Commission pre-
11 approval that if it acquires BMGS it will be afforded rate base treatment.

12 **B. Rate Base Adjustments.**

13 **1. Company's proposed Acquisition Discount Adjustment.**

14 The Company, Staff, and RUCO agree on the Company's proposed acquisition discount
15 adjustment of \$8,355,383.

16 **2. Post-Test Year Non-Revenue Plant in Service.**

17 The Commission should disallow the Company's proposed \$7,263,614 of post test year plant
18 from rate base because of "the small size of the investments relative to the Company's rate base, the
19 relatively non-essential, or on-going, nature of the investments, and the lack of support for the
20 revenue neutrality contention."¹⁸ The Company did not provide adequate justification in the form of
21 studies or analyses to support the Company's contention that the adjustment is revenue neutral.¹⁹ In
22 general where the Commission has allowed for inclusion of post test year plant, "the Post test year
23 plant was large relative to the rate base, the specific capital items were especially important for the
24 provision of safe and reliable service, and factors which caused the delay in completion of plant post
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26 ¹⁴ UNSE Final Schedule A-1.

27 ¹⁵ Staff Final Schedule THF A-1.

28 ¹⁶ UNSE Final Schedule A-1.

¹⁷ Staff Final Schedule THF B-1.

¹⁸ Ex. S-9 (Fish Direct) at 12:9-16:23.

¹⁹ Ex. S-9 (Fish Direct) at 12:23-26.

1 test year end were extraordinary."²⁰ In this case, unlike other cases in which the Commission has
2 included post-test-year plant in rate base, the \$7,263,614 of post test year plant makes up less than
3 4.2% of the adjusted original cost rate base.²¹ Furthermore, the post test year items are projects that
4 appear to be normal and on-going for electric utilities.²² Lastly, the Company has not established any
5 specific factors that prevented completion of any of the post test year projects.²³

6 **3. Accumulated Deferred Income Tax.**

7 Staff agrees with the Company and RUCO on the (\$684,777) accumulated deferred income
8 tax adjustment.²⁴

9 **4. Working Capital.**

10 Staff recommends a (\$19,519) adjustment to the Company's working capital
11 recommendation.²⁵

12 **5. Black Mountain Generating Station.**

13 Staff recommends that the Commission again deny the Company's request to include the
14 BMGS in rate base.²⁶ In the Company's last rate case, the Commission denied this request because
15 the Company did not own the plant, because the plant costs were not known and measureable, and
16 because the plant was not used and useful.

17 Unisource Energy Development Company ("UED") currently owns the BMGS and currently
18 provides power to UNSE pursuant to a five-year tolling agreement.²⁷ The BMGS is a two-unit
19 peaking facility in Mohave County.²⁸ The Company states that purchasing the BMGS "is in the best
20 interests for both the Company and its customers."²⁹ UNSE states that it plans to purchase the
21 BMGS from UED for \$62 million.³⁰ UNSE is requesting a post-test year rate base adjustment as well
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23 ²⁰ Ex. S-9 (Fish Direct) at 13:6-16:4; *See also* Commission Decision Nos. 65350, 66849, 67279, 68176, and 68864.

24 ²¹ Ex. S-9 (Fish Direct) at 16:8-9.

22 ²² Ex. S-9 (Fish Direct) at 16:9-10.

25 ²³ Ex. S-9 (Fish Direct) at 16:10-12.

24 ²⁴ UNSE Final Schedule B-2;

26 ²⁵ Staff Final Schedules THF B-2, B-3; Ex. S-9 (Fish Direct) at 17:5-19 and footnote 3; Ex. S-11 (Fish Surrebuttal) at 8:18-26.

27 ²⁶ Ex. S-9 (Fish Direct) at 50:21-22 and 55:1-56:5.

28 ²⁷ Ex. UNSE-3 (DeConcini Direct) at 13:9-17.

29 ²⁸ Ex. UNSE-3 (DeConcini Direct) at 13:15-16.

30 ²⁹ Ex. UNSE-3 (DeConcini Direct) at 13:16-17.

³⁰ Ex. UNSE-3 (DeConcini Direct) at 14:5-6.

1 as a rate reclassification to account for its proposed purchase of the BMGS.³¹ In Decision No. 70360,
2 the Commission granted UNSE permission to finance the purchase of the BMGS. However, the
3 Company has not yet elected to purchase the BMGS.³²

4 **a. The Black Mountain Generating Station Is Not Owned By UNSE.**

5 In order for an asset to be placed into rate base, the asset should be owned by the utility
6 requesting rate recognition. The BMGS does not currently belong to UNSE. It is the property of
7 UED. UNSE has not provided a sufficient basis for requesting that an asset of UED be placed into
8 the rate base of UNSE. Unless and until the BMGS is transferred to UNSE, it should not be placed
9 into UNSE's rate base.

10 **b. Not All Facts Are Known Regarding UNSE's Proposed Purchase of**
11 **the Black Mountain Generating Station.**

12 **c.**

13 BMGS should not be included in rate base before all facts regarding UNSE's acquisition of
14 the plant are known. As Dr. Fish stated:

15 [a]fter the purchase has been made, then the request for inclusion of
16 BMGS in rate base should be made. At that time, the Commission could
17 be expected to have the necessary facts to make a determination. At this
18 time, prior to the purchase, the Commission may not have all the
19 necessary information.³³

20 Because all facts surrounding the proposed purchase of the BMGS are not known at this time, Staff
21 recommends that the Company's requested rate base adjustment be denied.

22 **d. There Continues To be Uncertainty As To Whether The Company**
23 **Will Ever Purchase the Black Mountain Generating Station.**

24 In Decision No. 70360, the Commission not only encouraged UNSE's acquisition of BMGS,
25 but also "authorized UNSE to implement an accounting order to record any and all of the Company's
26 financial activities associated with the BMGS as if the BMGS were in rate base as of June 1, 2008."³⁴
27 The Commission also authorized the Company to acquire up to \$80,000,000 in new debt and equity
28 for the financing of BMGS.³⁵ Despite the Commission's favorable treatment of the Company's

29 ³¹ Ex. UNSE-3 (DeConcini Direct) at 14:5-8.

30 ³² Ex. UNSE-3 (DeConcini Direct) at 14:15-16.

31 ³³ Ex. S-11 (Fish Surrebuttal) at 2:22-25.

32 ³⁴ Ex. S-9 (Fish Direct) at 53:22-25; Ex. Ruco-1, Decision No. 70360

33 ³⁵ Ex. S-9 (Fish Direct) 55:17-21; Ex. Ruco-1, Decision 70360.

1 proposed purchase of the BMGS,³⁶ the Company chose not to purchase the BMGS.³⁷ It is therefore
2 all the more uncertain when, if at all, the Company will choose to purchase the BMGS.

3 **d. The Financial Consequences Associated With The Purchase Of the**
4 **Black Mountain Generating Station Do Not Appear Detrimental.**

5 The Company asserted that it will be unable to purchase the BMGS without Commission pre-
6 approval of the rate base treatment because the purchase of BMGS would under those circumstances
7 negatively impact the Company's financial position and credit profile.³⁸ However, as Mr. Parcell
8 notes:

9 the facility [BMGS] is presently financed by some combination of internal
10 funds of UniSource. It would appear that a potential interim source of
11 financing the facility would be the transfer of the assets and liabilities
within the UniSource framework to UNS Electric.

12 In addition, I note that UNS Electric has access to a revolving credit
13 facility, as cited in witness Pritz's testimony, which it shares with UNS
14 Gas. It is my understanding that UNS Electric may draw up to \$35
million on this facility. This would also appear to be a source of interim
financing for the potential purchase of Black Mountain.³⁹

15 Thus, the Company's financial position does not necessarily preclude the Company from purchasing
16 the BMGS without a rate base adjustment.

17 **e. This Record Does Not Provide A Prudence Review.**

18 Consistent with sound ratemaking principles, a utility may be given an opportunity to earn a
19 return on an investment after the Commission has made a determination that the cost of an asset was
20 prudently incurred. Staff did not conduct a prudence review of the Company's proposed purchase of
21 the BMGS because prior to all of the purchase details being known, it is impractical for Staff to
22 conduct a prudence review of the purchase.⁴⁰ Although RUCO supports the Company's request to
23 include the BMGS in rate base, RUCO did not conduct a prudence review of the proposed purchase
24 of the BMGS.⁴¹ Because of the number of unknown facts relating to the purchase of the BMGS.⁴²

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26 ³⁶ Ex. S-9 (Fish Direct) at 54:1-5; Ex. Ruco-1, Decision 70360.

³⁷ Ex. S-9 (Fish Direct) at 55:5-7.

27 ³⁸ Ex. UNSE-3 (DeConcini Direct) at 15:7-21.

³⁹ Ex. S-14 (Parcell Direct) at 20:9-17.

28 ⁴⁰ Tr. at 602-608; Ex. S-11 (Fish Surrebuttal) at 2:21-23.

⁴¹ Tr. at 598:2-7; Tr. at 601:1-7.

⁴² Tr. at 598:2-7; Tr. at 102:6-20.

1 and because a prudence review was not conducted, the Company's request to include the BMGS in
2 rate base should be denied.

3 **f. The Commission has not determined that the BMGS is "Used and**
4 **Useful".**

5 Because BMGS is not currently owned by UNSE and a unit of the plant experienced
6 mechanical failure during this proceeding.⁴³ Staff was unable to determine if BMGS is used and
7 useful for purposes of rate making. Until such determination is made, Staff finds that it is
8 inappropriate to recommend inclusion of BMGS in rate base

9 **g. The Operation and Maintenance Costs of BMGS are uncertain.**

10 UNSE did not demonstrate that the operation and maintenance costs of BMGS were fully
11 known and certain during this proceeding⁴⁴. Operation and maintenance costs of a facility such as
12 the BMGS could be significant depending on a number of factors.⁴⁵ In addition to other unknown
13 partial costs, the uncertainty regarding the operation and maintenance cost of BMGS, makes the final
14 cost of BMGS less certain; and makes the option of including BMGS in rate base less viable.

15 **h. At the time of the Hearing in this proceeding, BMGS was not fully**
16 **functional.**

17 As previously noted, BMGS has two 45 MW peaking units. At the time of hearing, one of the
18 units was not functional due to some mechanical failure.⁴⁶ Thus, the Company is seeking rate base
19 treatment of a plant item that was not fully functional. Although the Company contends that the
20 failed unit has been repaired and now functional, Staff has not performed its due diligence review. If
21 the Commission was to authorize inclusion of BMGS in rate base, prior to transfer of ownership to
22 UNSE, and prior to Staff performing necessary due diligence reviews, the ratepayers will be at risk of
23 paying for a plant with uncertain operational reliability. As a result, the ratepayers may be
24 responsible for paying for a future mechanical failure of BMGS.

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27 ⁴³ Tr. at 413:6-19.

28 ⁴⁴ Tr. at 412:18-24.

⁴⁵ Tr. at 434:16-435:10.

⁴⁶ Tr. at 414: 1-11.

1 **i.. Staff Recommendations.**

2 In addition to Staff's recommendation to deny the Company's request to include the BMGS in
3 rate base, Staff makes the following additional recommendations relating to the BMGS. Staff
4 recommends that "Staff re-observe the BMGS facility prior to any purchase of BMGS by UNSE."⁴⁷
5 Specifically, Staff is recommending a prudence or due diligence evaluation of the BMGS.⁴⁸ Lastly,
6 because Staff is recommending that the Company's requested \$61,970,352 be excluded as post test
7 year plant in service, Staff is also opposed to the Company's request for a BMGS working capital
8 adjustment of (\$587,494).⁴⁹

9 **C. RCND Adjusted.**

10 Staff recommends an adjusted RCND rate base of \$347,241,128.⁵⁰ The Company proposes a
11 RCND adjusted rate base of \$354,355,023.⁵¹ RUCO proposes a \$411,422,319 adjusted RCND rate
12 base.⁵²

13 **D. Fair Value Rate Base.**

14 Staff's recommended fair value rate base ("FVRB") is \$257,907,973.⁵³ The Company
15 proposes a FVRB of \$265,021,868.⁵⁴

16 **E. Operating Income.**

17 The Company proposed an adjusted test-year operating income of \$10,003,347.⁵⁵ Staff
18 recommended an adjusted test-year operating income of \$10,714,545.⁵⁶ The difference of \$711,198
19 between the Company's and Staff's adjusted test year income is described in the operating expenses
20 below.

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24 ⁴⁷ Ex. S-7 (Lewis Direct) at 26:20-27:5.

⁴⁸ Tr. at 429:6-430:5.

25 ⁴⁹ UNSE Final Schedule BMGS B-2.

⁵⁰ Staff Final schedule THF B-1.

26 ⁵¹ UNSE Final Schedule B-1.

⁵² RUCO Final Schedule BJ-1.

27 ⁵³ Staff Final Schedule THF B-1.

⁵⁴ UNSE Final Schedule BMGS B-3 at 2.

28 ⁵⁵ Staff Final Schedule THF C-1.

⁵⁶ Staff Final Schedule THF C-1.

1 **F. Operating Revenue Adjustments.**

2 **1. Retail Revenue & Purchased Power Annualization.**

3 Staff and RUCO are in agreement with the Company's retail revenue and purchased power
4 annualization adjustment of \$10,733,456.⁵⁷

5 **2. Wholesale Revenue and Purchased Power.**

6 Staff and RUCO are in agreement with the Company's proposed wholesale revenue and
7 purchased power adjustment of (\$10,168,115).⁵⁸

8 **3. Weather Normalization.**

9 Staff and RUCO are in agreement with the Company's proposed weather normalization
10 adjustment of (\$1,017,300).⁵⁹

11 **4. Customer Energy and Demand Normalization.**

12 Staff and RUCO are in agreement with the Company's proposed (\$2,820,565) customer
13 energy annualization and customer demand normalization adjustment.⁶⁰

14 **5. Fuel and PPFAC Revenue and Expense Normalization.**

15 Staff and RUCO agree with the Company's proposed fuel and PPFAC revenue and expense
16 normalization adjustment of (\$29,192,263).⁶¹

17 **6. CARES Discounts.**

18 As Dr. Fish explained:

19 The CARES program is a pricing plan available to residential
20 customers presently taking service under the Company's residential service
21 pricing plan whose gross annual income is not more than one hundred fifty
22 percent of the federal poverty level guideline effective at the time
23 qualification and annual certification is sought. Residential customers who
24 desire to qualify for the plan must make application to the Company for
25 qualification and provide verification to the Company that the customer's
household income does not exceed one hundred fifty percent of the federal
poverty level.⁶²

26 ⁵⁷ UNSE Final Schedule C-2

27 ⁵⁸ UNSE Final Schedule C-1 and C-2.

28 ⁵⁹ UNSE Final schedule C-2

⁶⁰ UNSE Final Schedule C-2

⁶¹ UNSE Final Schedule C-2

⁶² Ex. S-9 (Fish Direct) at 31:14-20.

1 Staff and RUCO agree with the Company's proposed (\$61,797) Customer Assistance
2 Residential Energy Support ("CARES") discount adjustment.⁶³ Although Staff initially
3 recommended disallowance of this adjustment, ⁶⁴ Staff was able to substantiate the Company's
4 adjustment.⁶⁵

5 **7. DSM & Renewables Revenue and Expense.**

6 Staff and RUCO both agree with the Company's proposed Demand-Side Management
7 ("DSM") and Renewables Revenue & Expense adjustment of (\$1,458,039).⁶⁶

8 **G. OPERATING EXPENSE ADJUSTMENTS.**

9 **1. Retail Revenue and Purchased Power Annualization.**

10 Staff and RUCO are in agreement on the Company's proposed (\$956,469) retail revenue and
11 purchased power annualization operating expense adjustment.⁶⁷

12 **2. Wholesale Revenue and Purchased Power.**

13 Staff and RUCO agree with the Company's recommended (\$10,168,115) wholesale revenue
14 and purchased power adjustment.⁶⁸

15 **3. Weather Normalization (\$830,613).**

16 Staff and RUCO agree with the Company's recommended (\$830,613) weather normalization
17 adjustment.⁶⁹

18 **4. Customer Energy and Demand Normalization.**

19 Staff and RUCO agree with the Company's recommended (\$1,079,814) customer energy and
20 demand normalization adjustment.⁷⁰

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25 ⁶³ Tr. at 462-463; Staff Final Schedule THF C-11; UNSE Final Schedule C-2; RUCO Final schedule BJ-7.

26 ⁶⁴ Ex. S-9 (Fish Direct) at 32:7-13; Ex. S-11 (Fish Surrebuttall) at 16.

27 ⁶⁵ Tr. at 462.

28 ⁶⁶ UNSE Final Schedule C-2.

⁶⁷ UNSE Final Schedule C-2.

⁶⁸ UNSE Final Schedule C-2.

⁶⁹ UNSE Final Schedule C-2.

⁷⁰ UNSE Final Schedule C-2.

1 **5. Fuel and Purchased Power Fuel Adjuster Clause Revenue and Expense**
2 **Normalization.**

3 Staff and RUCO agree with the Company's recommended (\$19,024,147) fuel and purchased
4 power and fuel adjustment clause ("PPPFAC") revenue and expense normalization adjustment.⁷¹

5 **6. DSM and Renewables Revenue and Expense.**

6 Staff and RUCO agree with the Company's recommended (\$1,626,826) DSM and renewables
7 revenue and expense adjustment.⁷²

8 **7. Payroll Expense.**

9 Staff agrees with the Company's proposed \$220,252 payroll expense adjustment.⁷³

10 **8. Payroll Tax Expense.**

11 Staff agrees with the Company's proposed \$55,054 payroll tax expense adjustment.⁷⁴

12 **9. Pension and Benefits.**

13 Staff and RUCO agree with the Company's proposed \$210,866 pension and benefits
14 adjustment.⁷⁵

15 **10. Post Retirement Medical.**

16 Staff and RUCO agree with the Company's proposed \$161,929 post retirement medical
17 adjustment.⁷⁶

18 **11. Rate Case Expense.**

19 Staff and RUCO recommend that the Commission allow the Company to recover \$300,000 in
20 rate case expenses over three years. Therefore, Staff recommends a pro forma adjustment to reduce
21 the Company's proposed rate case expense by \$66,667.⁷⁷ Staff's adjustment is reasonable and
22 identical to the Commission's treatment of rate case expense in UNSE's last rate case (Decision No.
23 70360) and the UNS Gas Decision No. 70011.⁷⁸

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25 ⁷¹ UNSE Final Schedule C-2.

26 ⁷² Id.

27 ⁷³ Id.

28 ⁷⁴ Id.

⁷⁵ Id.

⁷⁶ Id.

⁷⁷ Ex. S-9 (Fish Direct) at 31:1-10; Staff Final Schedule THF C-10.

⁷⁸ Ex. S-9 (Fish Direct) at 31:1-10.

1 **12. Bad Debt Expense.**

2 Staff recommends a \$105,487 bad debt expense adjustment to the Company's proposed
3 adjustment of (\$436,411).⁷⁹ The Company's calculation of its bad debt pro forma adjustment is
4 flawed because, as Dr. Fish noted, "[t]he Company based its ratio of uncollectibles to sales on gross
5 sales tax but calculated its adjusted amount on adjusted sales."⁸⁰ Therefore the Company's
6 adjustment overstates the amount of bad debt expense.⁸¹ Staff's adjustment corrects the Company's
7 overstatement.⁸²

8 **13. Interest on Customer Deposits.**

9 Staff and RUCO agree with the Company's (\$145,701) interest on customer deposit
10 adjustment.⁸³

11 **14. Workers Compensation.**

12 Staff and RUCO agree with the Company's (\$115,528) workers compensation adjustment.⁸⁴

13 **15. Miscellaneous Expenses – Industry Association Dues.**

14 Staff recommends a \$4,763 adjustment to the Company's requested (\$451,888) industry
15 association dues adjustment.⁸⁵ Staff recommends this adjustment to eliminate 49.93 percent of
16 Edison Electrical Institute ("EEI") dues related to legislative advocacy, regulatory advocacy,
17 advertising, marketing, and public relations.⁸⁶ This adjustment eliminates that proportion of dues
18 related to activities unnecessary for the provision of service to UNSE customers.⁸⁷

19 **16. Miscellaneous Expenses – Outside Legal.**

20 Staff recommends a pro forma adjustment of \$27,359 to the Company's recommended
21 outside legal expenses using a four-year normalization period for 2005-2008.⁸⁸ The Company
22 recommends \$138,000 for outside legal expenses, by normalizing the 2005 through 2007 legal
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24 ⁷⁹ Staff Final Schedule THF C-2 and C-12; UNSE Final Schedule C-2.

25 ⁸⁰ Ex. S-9 (Fish Direct) at 33:9-16.

26 ⁸¹ Ex. S-9 (Fish Direct) at 33:16-17.

27 ⁸² Ex. S-9 (Fish Direct) at 33:17-18.

28 ⁸³ UNSE Final Schedule C-2, page 3 of 4.

⁸⁴ UNSE Final Schedule C-2, page 3 of 4.

⁸⁵ Ex. S-11 (Fish Surrebuttal) at 12; Staff Final Schedule THF C-2.

⁸⁶ Tr. at 328-329; Ex. R-1 (Decision 70360); Ex. S-9 (Fish Direct) at 27:8-16.

⁸⁷ Ex. S-9 (Fish Direct) at 27:18-20.

⁸⁸ Ex. S-9 (Fish Direct) at 15:2-11; Staff Final schedule THF C-8

1 expenses.⁸⁹ RUCO recommends \$76,503 for outside legal expenses by normalizing the 2006 through
2 2008 legal expenses.⁹⁰ Because the 2007 adjusted value is the highest of the four years, and the 2008
3 adjusted value is the smallest, Staff recommends a four-year normalization period of 2005 through
4 2008.⁹¹

5 **17. A&G Expense Capitalized.**

6 The parties are in agreement regarding the A&G Expense Capitalized expense of \$229,429.⁹²

7 **18. Depreciation & Property Tax – Post Test Year Non-Revenue Plant in**
8 **Service.**

9 The Company proposed a pro forma adjustment of depreciation and property tax as a result of
10 its proposed post-test year plant in service adjustment of \$442,526.⁹³ Staff and RUCO recommend
11 disallowance of this adjustment because Staff and RUCO both recommend removal of the post-test
12 year plant in service adjustment proposed by the Company.⁹⁴

13 **19. Depreciation and Amortization Expense Annualization.**

14 The parties are in agreement regarding the Depreciation and Amortization Expense
15 Annualization adjustment of (\$507,792).⁹⁵

16 **20. Property Tax Expense.**

17 Although the Company is now recommending \$105,181 in property tax expenses, Staff
18 continues to recommend the Company's initial proposed property tax expense reduction of \$7,358.⁹⁶

19 **21. Wholesale Credit Support.**

20 Staff recommends that the Commission deny the Company's request to recover a 1.15%
21 credit support charge through the Company's PPFAC.⁹⁷ As Dr. Fish notes,
22
23

24 ⁸⁹ Ex. UNSE (Dukes Direct) at 25:5-15.

25 ⁹⁰ Ex. RUCO-6 (Johnson Direct) at 40:17-19.

26 ⁹¹ Ex. S-11 (Fish Surrebuttal) at 14:21-15:11.

27 ⁹² UNSE Final Schedules C-2 at 3; RUCO Final Schedule BJ-7 at 3.

28 ⁹³ UNSE Final Schedules C-2 at 3.

⁹⁴ Ex. S-9 (Fish direct) at 34:9-12; Ex. RUCO-6 (Johnson Direct) at 41:18-25.

⁹⁵ UNSE Final Schedule C-2 at 4.

⁹⁶ Ex. UNSE-7 (Kissinger Rebuttal) at 1:14-2:5; Ex. RUCO-6 (Johnson Direct) at 41:18-25; Ex. S-9 (Fish Direct) at 34:1-15.

⁹⁷ Ex. S-9 (Fish Direct) at 49:5-7.

1 First the costs recovered by PPFAC should be directly related to purchased
2 power or fuel costs. The PPFAC currently does this by allowing only for
3 recovery of expenses recorded in FERC Accounts 501, 547, 555, and 565. In
4 its last case the Company requested certain other costs be recovered through
5 the PPFAC and was denied. The Commission noted that no other utility was
6 permitted to recover such costs and could see no valid reason to depart. The
7 same reasoning still holds. Second, the Company has another way to recover
8 those costs. It can request recovery of credit support costs, broker's fees, legal
9 fees and other related costs through rate cases.⁹⁸

10 Therefore, the Commission should deny the Company's request to recover a 1.15% credit
11 support charge through the Company's PPFAC.

12 **22. Fleet Fuel Expense.**

13 Staff recommends a \$75,798 reduction to test year fleet fuel expenses based on 2009 fuel
14 price data.⁹⁹ The Company recommended a \$56,333 reduction based on the average fuel cost based
15 on data from 2007 through October 2009. Because fuel prices were unusually high during the first
16 half of the test year, Staff used the average of 2009 actual monthly prices through November 2009
17 plus the projected average monthly price for the remainder of 2009 which results in an average
18 gasoline price of \$2.52 per gallon and \$2.65 per gallon for diesel.¹⁰⁰ Staff's proposal should be
19 adopted because it represents a more reasonable and realistic fuel cost.

20 **23. Incentive Compensation – Productivity Enhancement Program and
21 Related Payroll Tax Expense.**

22 Staff recommends that 50% of productivity enhancement program ("PEP") incentive
23 compensation, or \$132,158, be included in operating income because both the Company stock
24 holders and rate payers benefit from the PEP incentive compensation expenses.¹⁰¹ Staff's
25 recommendation is also supported by the prior UNSE Decision No. 70360. In accordance with this
26 recommendation, Staff also recommends a \$10,110 reduction in payroll tax expense related to the
27 50% disallowed portion of the incentive compensation expense.¹⁰²

28 ⁹⁸ Ex. S-9 (Fish Direct) at 49:9-17.

⁹⁹ Ex. S-9 (Fish Direct) at 30:9-10; Staff Final Schedule THF C-9.

¹⁰⁰ Ex. S-9 (Fish Direct) at 30:2-10.

¹⁰¹ Ex. S-9 (Fish Direct) at 23:24-24:2; Staff Final Schedule THF C-3.

¹⁰² Ex. S-9 (Fish Direct) at 24:11-21.

1 **24. Incentive Compensation – Supplemental Executive Retirement Plans.**

2 As in the prior UNSE Decision No. 70360, Staff is recommending 100% disallowance of the
3 supplemental executive retirement plan (“SERP”) incentive compensation expense of \$102,142.¹⁰³
4 As noted by Dr. Fish, “if the Company wishes to reward its top executives with high levels of
5 retirement benefits, then, since the Company owners benefit, owners should shoulder the burden.”¹⁰⁴
6 RUCO agrees with Staff’s recommendation to disallow SERP incentive compensation.¹⁰⁵

7 **25. Call Center Expense.**

8 Staff recommends that the Commission disallow \$99,476 in call center expense.¹⁰⁶ In the
9 prior UNSE rate case, Decision No. 70360, the Commission allowed the Company to recover the full
10 amount of Call Center expenses incurred because of the significant increase in call volume the
11 Company had experienced since consolidating its Call Center operations with UNS Gas Inc. and
12 Tucson Electric Power Company, and because maintaining a separate UNSE Call Center on a stand-
13 alone basis would have required additional investment.¹⁰⁷ However, in this case, because the
14 Company call center volume actually decreased by 15% since the Company’s prior rate case, Staff
15 determined that an increase was not warranted.¹⁰⁸

16 **26. Synchronized Interest.**

17 Although RUCO proposed a \$52,172 synchronized interest adjustment, Staff and the
18 Company both included this with the current income tax adjustment.¹⁰⁹

19 **27. Black Mountain Generating Station.**

20 As noted previously, Staff recommends that the Commission again deny the Company’s
21 request for Commission pre-approval to acquire the BMGS.¹¹⁰ As a result, Staff is also
22 recommending denial of the Company’s requested BMGS purchased power adjustment (“PPA”) of
23 (\$10,960,779),¹¹¹ BMGS O&M Expense of \$1,158,464, BMGS Depreciation and Amortization

24
103 Ex. S-9 (Fish Direct) at 24:4-9; Staff Final Schedule THF C-4.

25 104 Ex. S-9 (Fish Direct) at 24:7-9.

105 Ex. RUCO-6 (Johnson Direct) at 43:26-44:2.

26 106 Ex. S-11 (Fish Surrebuttal) at 13:2-4; Staff Final Schedule THF C-6.

107 Ex. S-9 (Fish Direct) at 25:4-12.

27 108 Ex. S-9 (Fish Direct) at 25:23-26:14.

109 Ex. RUCO-6 (Johnson Direct) at 43:1-23; RUCO Final Schedules BJ-7.

28 110 Ex. S-9 (Fish Direct) at 50:21-22 and 55:1-56:5.

111 Ex. S-9 (Fish Direct) at 56:1-5.

1 Annualization Expense of \$1,649,496, BMGS Property Tax Expense of \$434,148,¹¹² and the
2 Company's proposed \$2,074,196 BMGS income tax expense.

3 **28. Income Tax – Base Case.**

4 Staff recommends an income tax adjustment of (\$167,647).¹¹³

5 **III. COST OF CAPITAL.**

6 Staff is recommending an overall cost of capital of 8.40%.¹¹⁴ The Company proposes an
7 overall cost of capital of 9.04%.¹¹⁵ RUCO recommends an overall cost of capital of 8.06%.¹¹⁶
8 Staff's well supported and reasonable recommendation provides the Company with a sufficient level
9 of earnings.¹¹⁷

10 **A. Capital Structure.**

11 Staff is in agreement with the Company and RUCO and recommends that the Company's
12 proposed adjusted test year capital structure of 54.24% debt and 45.76% equity be used in
13 determining the total cost of capital.¹¹⁸

14 **B. Cost of Equity.**

15 Staff recommends a 10% cost of equity be used in determining the total cost of capital in this
16 rate case.¹¹⁹ The Company is recommending an 11.4% cost of equity.¹²⁰ RUCO recommends a
17 9.25% cost of equity.¹²¹ The primary difference between the parties overall cost of capital is due to
18 the computation of the Company's cost of equity.

19 Staff witness David C. Parcell, President and Senior Economist of Technical Associates,
20 Richmond, Virginia, presented Staff's position on cost of capital.¹²² Mr. Parcell holds an M.A.
21 degree in economics from Virginia Polytechnic Institute and State University and a M.B.A. from
22

23 ¹¹² Ex. S-9 (Fish Direct) at 34:1-15; Staff Final Schedule THF C-13.

24 ¹¹³ Staff Final Schedule THF C-2 at 2.

24 ¹¹⁴ Ex. S-14 (Parcell Direct) at 41:6-7; Staff Final Schedule DCP-1, Schedule 1.

25 ¹¹⁵ Ex. UNSE-22 (Pritz Direct) at 18:13-15; UNSE Final Schedule A-1.

25 ¹¹⁶ Ex. RUCO-10 (Rigsby Direct) at 6:5-7; RUCO Final Schedules WAR 1

25 ¹¹⁷ Ex. S-14 (Parcell Direct) at 41:1-16; Staff Final Schedule DCP-1; Staff Final Schedule DCP 14.

26 ¹¹⁸ Ex. S-14 (Parcell Direct) at 23:13-25; Ex. UNSE-22 (Pritz Direct) at 4:7-5:15; Ex. RUCO-10 (Rigsby Direct) at 48:15-49:4; Staff Final Schedule DCP 1; RUCO Final Schedules WAR-1; UNSE Final Schedules D-1.

27 ¹¹⁹ Ex. S-14 (Parcell Direct) at 38:6-20; Ex. S-15 (Parcell Surrebuttal) at 2:1-12; Staff Final Schedule DCP-1.

27 ¹²⁰ Ex. UNSE-22 (Pritz Direct) at 17:13-20..

28 ¹²¹ Ex. RUCO-10 (Rigsby Direct) at 6:9.

28 ¹²² Ex. S-14 (Parcell Direct) at 1:1-2:5.

1 Virginia Commonwealth University.¹²³ Mr. Parcell has provided cost of capital testimony in public
2 utility ratemaking proceedings dating back to 1972 in approximately 450 utility proceedings before
3 40 regulatory agencies in the United States and Canada.¹²⁴

4 **1. Cost of Common Equity.**

5 Because UNSE is not publicly traded, it is not possible to apply cost of equity models directly
6 to it.¹²⁵ While its parent UniSource Energy is publicly traded, the results of a direct analysis applied
7 to this Company would be of limited value because of its diversified nature.¹²⁶ Consequently, Mr.
8 Parcell used a group of comparison, or proxy, companies to determine UNSE's cost of equity.¹²⁷ Mr.
9 Parcell used three different methodologies to estimate the Company's cost of equity: the discounted
10 cash flow ("DCF"), capital asset pricing model ("CAPM"), and comparable earnings ("CE")
11 analyses.¹²⁸ Ms. Pritz argues that Staff's cost of equity recommendation "is low due to the use of
12 inappropriate inputs in several of the methods upon which he [Mr. Parcell] relies."¹²⁹ However,
13 Staff's recommendation is sound and based upon the same DCF, CAPM, and CE analyses that were
14 used by the Commission in UNSE's most recent rate case.¹³⁰

15 **2. DCF.**

16 The DCF Model is based upon the dividend discount model and determines the value or price
17 of a security by calculating the discounted present value of all future cash flows.¹³¹ Results under the
18 DCF Model were calculated by Mr. Parcell assuming that dividends are expected to grow at a
19 constant rate.¹³² The DCF equation recognizes that the return expected by investors is comprised of
20 dividend yield (current income) and expected growth in dividends (future income).¹³³

21
22
23

¹²³ Id.

24 ¹²⁴ Id.

25 ¹²⁵ Ex. S-14 (Parcell Direct) at 24:16-22..

26 ¹²⁶ Id.

27 ¹²⁷ Id.

28 ¹²⁸ Ex. S-14 (Parcell Direct) at 8:17-9:6.

¹²⁹ Ex. UNSE-23 (Pritz Rebuttal at 1-2.

¹³⁰ Ex. S-15 (Parcell Surrebuttal) at 2:1-12; *See also* Docket No. E-04204A-06-0783.

¹³¹ Ex. S-14 (Parcell Direct) at 25:8-29:15.

¹³² Ex. S-14-(Parcell Direct) at 25:16-17.

¹³³ Ex. S-14 (Parcell Direct) at 26:1-3.

1 In determining a DCF return, Mr. Parcell combined the current dividend yield for each group
2 of proxy utility stocks with several indicators of expected dividend growth.¹³⁴ Mr. Parcell considered
3 the following five indicators of growth in his DCF analyses:

- 4 1. 2004-2008 (5-year average) earnings retention, or fundamental growth (per
5 Value Line);
- 6 2. 5-year average of historic growth in earnings per share ("EPS"), dividends per
7 share ("DPS"), and book value per share ("BVPS") (per Value Line);
- 8 3. 2009, 2010, and 2012-2014 projections of earnings retention growth (per
9 Value Line); and
- 10 4. 2006-2008 to 2010-2014 projections of EPS, DPS, and BVPS (per Value
11 Line); and
- 12 5. 5-year projections of EPS growth as reported in First Call (per Yahoo!
13 Finance).¹³⁵

14 The DCF results in Schedule 7 of Mr. Parcell's direct testimony indicate average DCF cost rates of
15 approximately 9.4%%-10.1%.¹³⁶ The Company takes issue with Staff's use of historic data and
16 retention growth (historic and prospective) as sources of growth projection and growth indication.¹³⁷
17 However, as Mr. Parcell stated in surrebuttal testimony:

18 I have previously noted in my direct testimony (pages 42-45) why it is
19 improper to exclusively rely on earnings per share ("EPS") forecasts and also
20 that such an exclusive reliance is not reflective of investor expectations.

21 Ms. Pritz attempts to justify her exclusive reliance on analysts' forecasts of
22 EPS growth on her belief that "analysts providing forward-looking growth
23 estimates will have already considered historical growth in determining the
24 outlook for a company." This viewpoint is not a sufficient reason to assume
25 that investors ignore historic growth and focus exclusively on analysts'
26 forecasts. It should be apparent, based upon the experience of the past two
27 years, that analysts have not been accurate in projecting EPS and, further, any
28 investors who were unfortunate enough to have exclusively relied on such
forecasts would have been sorely disappointed with their investment
performance. In any event, recent performance of analysts' estimates would
give investors even more reason to consider other growth indicators in making
their investment decisions.

I further note that the preponderance of financial information provided to
investors, both by individual companies and investment services such as
Value Line, is historic data. It is neither realistic nor accurate to maintain that

¹³⁴ Ex. S-14 (Parcell Direct) at 26:5-8..

¹³⁵ Ex. S-14 (Parcell Direct) at 27:18-28:5.

¹³⁶ Ex. S-14 (Parcell Direct) at 29:6-8.

¹³⁷ Ex. UNSE-23 (Pritz Rebuttal) at 2-3.

1 all of this information is ignored by investors, but this is what Ms. Pritz is
2 maintaining.¹³⁸

3 Furthermore, the Company's claim that short-term growth (in a DCF context) should reflect only
4 prospective data, and that long-term growth should only use historic data is inconsistent.¹³⁹ As Mr.
5 Parcell notes:

6 prospective GDP growth is about 4.5 percent, well below that 6.5 percent
7 level [Ms. Pritz] uses.¹⁴⁰ Lastly, the Company's implication that its 6.5
8 percent long-term growth rate reflects GDP projections is largely untrue
9 because the Company averages GDP estimates with other and higher growth
10 rates, such as EPS projections and the "outlook for the electric utility
11 industry."¹⁴¹

12 3. CAPM

13 Staff's CAPM analysis resulted in a cost of 7.6%-8.3% for UNSE.¹⁴² The CAPM model, a
14 version of the risk premium method, describes the relationship between a security's investment risk
15 and its market rate of return.¹⁴³ Mr. Parcell used the same group of proxy companies when
16 calculating the cost of equity using CAPM.¹⁴⁴

17 The first variable in the CAPM equation is the risk-free rate which is generally recognized by
18 use of U.S. Treasury securities.¹⁴⁵ Mr. Parcell used the three-month average yield (July-September,
19 2009) for 20-year U.S. Treasury bonds of 4.28%.¹⁴⁶ The next variable in the CAPM equation is beta,
20 which is a measure of the relative volatility or risk of a stock in relation to the overall market.¹⁴⁷ To
21 calculate the risk premium (the investor expected premium of common stock over the risk-free rate)
22 Mr. Parcell used the S&P 500 and 20-year U.S. Treasury Bonds.¹⁴⁸ Using both arithmetic and
23 geometric means, this yielded a risk premium of about 5.32%.¹⁴⁹ As Mr. Parcell stated, "[i]t is
24 apparent that investors have access to both types of returns, and correspondingly use both types of

25 ¹³⁸ Ex. S-15 (Parcell Surrebuttal) at 2:15-3:15.

26 ¹³⁹ Ex. UNSE-23 (Pritz Rebuttal) at 5; Ex. S-15 (Parcell Surrebuttal) at 4:1-7.

27 ¹⁴⁰ Ex. S-14 (Parcell Direct) at 45-47; Ex. S-15 (Parcell Surrebuttal) at 4:5-7.

28 ¹⁴¹ Ex. S-15 (Parcell Surrebuttal) at 4:9-12.

¹⁴² Ex. S-14 (Parcell Direct) at 33:4-8.

¹⁴³ Ex. S-14 (Parcell Direct) at 29:20-24.

¹⁴⁴ Ex. S-14 (Parcell Direct) at 30:21-22.

¹⁴⁵ Ex. S-14 (Parcell Direct) at 31:1-7.

¹⁴⁶ Ex. S-14 (Parcell Direct) at 31:10-12.

¹⁴⁷ Ex. S-14 (Parcell Direct) at 31:14-16.

¹⁴⁸ Ex. S-14 (Parcell Direct) at 31:24-32:2.

¹⁴⁹ Ex. S-14 (Parcell Direct) at 32:12-23.

1 returns, when they make investment decisions.”¹⁵⁰ Further, in UNSE’s last rate case, in Decision No.
2 70360, the Commission stated, “We agree with the Staff that it is appropriate to consider the
3 geometric returns in calculating a comparable company CAPM because to do otherwise would fail to
4 give recognition to the fact that many investors have access to such information for purposes of
5 making investment decisions.”¹⁵¹

6 Although the Company’s updated DCF and CAPM analyses resulted in a reduced average
7 cost of equity of 10.8%, the Company declined to change its recommendation.¹⁵² Ms. Pritz stated in
8 rejoinder:

9 My updated DCF analysis indicates an 11.2% return on equity, my bond yield
10 plus risk premium (“BYRP”) calculation shows 10.3%, and my CAPM
11 analysis shows 8.9%. Based on a comparison to typical risk premiums for
12 equity relative to debt, the result of the CAPM analysis appears too low to be
meaningful. The average cost of equity indicated by the other two methods,
as updated, is 10.8%.¹⁵³

13 Had the Company recommended its own updated cost of equity of 10.8%, its recommendation would
14 be only .8 of a percentage point higher than Staff’s recommended 10% cost of equity.

15 **4. CE.**

16 Staff’s CE analysis indicated a cost of equity of 9.5% to 10.5%.¹⁵⁴ The CE method is based
17 upon the “corresponding risk” standard of the United States Supreme Court’s decisions in *Bluefield*
18 *Water Works and Improvement Co. v. Public Serv. Comm’n of West Virginia*, 262 U.S. 679 (1923)
19 and *Federal Power Comm’n v. Hope Natural Gas Co.*, 230 U.S. 591 (1942).¹⁵⁵ The CE method is
20 “designed to measure the returns expected to be earned on the original cost book value of similar risk
21 enterprises.”¹⁵⁶ Mr. Parcell’s CE analysis is based on market data (through the use of market-to-book
22 ratios) and is thus a market test.¹⁵⁷ In his CE analysis Mr. Parcell considered the experienced equity
23 returns of the proxy groups of utilities for the period 1992-2009 (i.e. the last eighteen years).¹⁵⁸ The

24
¹⁵⁰ Ex. S-15 (Parcell Surrebuttal) at 4:18-19.

25 ¹⁵¹ Decision No. 70360 (UNSE Docket No. E-04204A-06-0783); See also Ex. S-15 (Parcell Surrebuttal) at 5:3-8.

26 ¹⁵² Ex. UNSE-24(Pritz Rejoinder) at 6:9-14; Tr. at 732:16-733:8.

27 ¹⁵³ Ex. UNSE-24 (Pritz Rejoinder) at 6:9-14.

28 ¹⁵⁴ Ex. S-14 (Parcell Direct) at 37:2-3.

¹⁵⁵ Ex. S-14 (Parcell Direct) at 33:1-13.

¹⁵⁶ Ex. S-14 (Parcell Direct) at 33:17-18.

¹⁵⁷ Ex. S-14 (Parcell Direct) at 33:22-34:19.

¹⁵⁸ Ex. S-14 (Parcell Direct) at 34:22-23.

1 CE analysis requires the use of a long period of time to determine trends in earnings over at least a
2 full business cycle.¹⁵⁹ Mr. Parcell discussed his results in direct testimony:

3 These results indicate that historic returns of 8.2 percent to 11.1 percent have
4 been adequate to produce market-to-book ratios of 120 percent to 157 percent
5 for the groups of proxy utilities. Furthermore, projected returns on equity for
6 2010 and 2012-2014 are within a range of 8.5 percent to 10.2 percent for the
 utility groups. These relate to 2008 market-to-book ratios of 115 percent or
 higher.¹⁶⁰

7 After conducting the CE analysis Mr. Parcell determined that "the CE analysis indicates that the cost
8 of equity for the proxy utilities is no more than 9.5 percent to 10.5 percent." He also determined that
9 an earned return of 9.5%-10.5% should result in a market-to-book ratio of over 100%.¹⁶¹

10 **5. Overall Cost of Equity Recommendation.**

11 Staff's three methodologies produce the following cost of equity determinations:

12 Discounted Cash Flow	9.4-10.1%
13 Capital Asset Pricing Model	7.6-8.3%
14 Comparable Earnings	9.5-10.5% ¹⁶²

15 Staff recommends an overall cost of equity of 10% from a range of 9.5% to 10.5%.¹⁶³

16 **C. Cost Of Debt.**

17 Staff agrees with the Company and RUCO and recommends that the Company's proposed
18 actual cost of long-term debt at December 31, 2008 of 7.05% be used in determining the Company's
19 overall cost of capital in this rate case.¹⁶⁴

20 **D. Total Cost of Capital.**

21 Staff proposes a total cost of capital be approved, which adopts the cost of capital
22 recommended by Mr. Parcell:

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24
25

¹⁵⁹ Ex. S-14 (Parcell Direct) at 34:23-25.

¹⁶⁰ Ex. S-14 (Parcell Direct) at 35:24-36:2.

¹⁶¹ Ex. S-14 (Parcell Direct) at 37:8-10.

¹⁶² Ex. S-14 (Parcell Direct) at 38:9-12.

¹⁶³ Ex. S-14 (Parcell Direct) at 38:17-20.

¹⁶⁴ Ex. S-14 (Parcell Direct) at 24:1-13; Ex. RUCO-10 (Rigsby Direct) at 48:1-13; Ex. UNSE-22 (Pritz Direct) at 17:22-18:9.

1	Long-Term Debt	54.24%	7.05%	3.82%
2	Common Equity	45.76%	10.00%	4.58%
3	Total			8.40%

4 Staff's recommended overall cost of capital of 8.40% is reasonable and well supported by sound
5 methodologies and analyses and should be adopted in determining rates in this case.

6 **E. Fair Value Rate Base Cost Of Capital.**

7 Staff recommends a total fair value rate of return of 6.01% for investor-supplied capital.¹⁶⁵
8 Alternately, if the Commission determines that a specific return (greater than zero) should be applied
9 to the FVRB increment of 1.5% from a range of 0 to 3%.¹⁶⁶

10 As Mr. Parcell noted in direct testimony:

11 both the cost of debt and the return on common equity (i.e., capital stock,
12 paid-in capital, and retained earnings – the investment of common
13 shareholders) are already provided for in a traditional [weighted cost of
14 capital]. Only the portion of the FVRB that exceeds OCRB ("Fair Value
Increment") needs to have a specific return identified in order to reflect a
return component on that Fair Value Increment.¹⁶⁷

15 **IV. RATE DESIGN.**

16 Staff is recommending an overall 4.76% increase to adjusted test year revenues and a 5.17%
17 increase to residential customers.¹⁶⁸ The Company proposes an overall increase of 8.48% to adjusted
18 test year revenues and a 9.21% increase to residential customers.¹⁶⁹ Staff's recommended rate design
19 was developed to recover the Company's revenue requirement of \$168,405,427.¹⁷⁰

20 **A. Monthly Customer Charge And Commodity Charge.**

21 Staff and the Company agree that the \$7.50 monthly residential customer charge should be
22 increased to \$8.00.¹⁷¹ RUCO recommends that the monthly residential customer charge should be

25 ¹⁶⁵ Ex. S-15 (Parcell Surrebuttal) at 8:22-23; Staff Final Schedules THF A-1

26 ¹⁶⁶ Ex. S-14 (Parcell Direct) at 57:5-17.

27 ¹⁶⁷ Ex. S-14 (Parcell Direct) at 55:4-8.

28 ¹⁶⁸ Ex. S-13 (Stewart Surrebuttal) Executive Summary.

¹⁶⁹ Id..

¹⁷⁰ Ex. S-12 (Stewart Direct) at 3:6-8.

¹⁷¹ Ex. UNSE-20 (Erdworm Rejoinder) at 1:19-23.

1 reduced to \$5.00.¹⁷² Staff also supports the Company's proposed continuation of the current
2 residential inclining block rate structure.¹⁷³ RUCO recommends a three block rate design.¹⁷⁴

3 **B. Allocation Of Revenue Increase.**

4 The Customer Assistance Residential Energy Support ("CARES") program is a low income
5 assistance program. The Company initially proposed expanding the CARES program to include
6 customers with incomes up to 200% of the poverty guidelines.¹⁷⁵ Staff agreed with the Company's
7 proposed expansion of the program to customers with income levels at 200% of poverty
8 guidelines.¹⁷⁶ However, in light of RUCO's position, the Company changed its position in rejoinder
9 testimony to where it was no longer taking a position on the expansion of the CARES program.¹⁷⁷
10 However, during the hearing, the Company clarified its position indicating that it was all right with
11 expansion of the CARES program as long as it has ability to recover the costs of expanding the
12 program.¹⁷⁸

13 Staff recommends that the PPFAC rate for CARES customers be set at zero unless fuel and
14 purchased power costs reduce and result in a negative PPFAC rate.¹⁷⁹ As Mr. Stewart notes, "The
15 purpose of the CARES program is to provide an opportunity for those UNSE customers who are
16 facing more difficult economic circumstances than their more fortunate neighbors to obtain electric
17 service."¹⁸⁰

18 Staff is in agreement with the Company's proposed changes to time of use ("TOU") pricing
19 plans.¹⁸¹ Although Staff agrees conceptually with the Company's proposed constant increase per
20 customer class, Staff proposes a different increase amount as follows:

24 ¹⁷² Ex. Ruco-6 (Johnson Direct) at 22:14-16.

¹⁷³ Ex. UNSE-20 (Erdwurm Rejoinder) at 1:26-2:1.

25 ¹⁷⁴ Ex. Ruco-6 (Johnson Direct) at 16:17-17:8.; UNSE-20 (Erdwurm Rejoinder) at 2:1-2.

¹⁷⁵ Ex. UNSE-18 (Erdwurm Direct) at 3:17-19; Ex. S-12 (Stewart Direct) at 7:20-21.

26 ¹⁷⁶ Ex. S-12 (Stewart Direct) at 8:7-9.

¹⁷⁷ Ex. UNSE-20 (Erdwurm Rejoinder) at 8:8-10.

27 ¹⁷⁸ Tr. at 282:23-283:3.

¹⁷⁹ Ex. S-13 (Stewart Surrebuttal) at 2:15-21.

28 ¹⁸⁰ Ex. S-13 (Stewart Surrebuttal) at 2:23-26.

¹⁸¹ Ex. S-12 (Stewart Direct) at 10:6-11:6.

Residential:	5.17%
Residential CARES	-5.23%
Small General Service	5.17%
Large General Service	5.17%
Large Power Service	5.17%
Lighting	5.17%
Total	4.76%. ¹⁸²

Staff's recommended rates and rate design should be adopted because they are efficient, equitable and provide the Company an adequate opportunity to recover its cost of providing service.

V. MISCELLANEOUS ISSUES.

A. Rules and Regulations.

1. Line Extension Tariff Revisions.

On June 26, 2008, pursuant to Decision No. 70360, UNSE filed its proposed revisions to Section 2 (Definitions), Section 6 (Service Lines and Establishments) and Section 9 (Line Extensions).¹⁸³ As noted by Mr. Rozen, the revision to Section 9 would eliminate the 400 feet of free footage and related provisions by "requiring the customer to pay the estimated cost of constructing line extension up front, and also add a transition period for customers to make plans before the elimination of the free footage."¹⁸⁴ The Company proposed revisions to Sections 2 and 6 to conform with the revisions to Section 9.¹⁸⁵ In Decision No. 71285, the Commission approved the revisions to Sections 6 and 9.¹⁸⁶ Staff recommends that once these revisions are final, the Company be ordered to file a copy of the revised tariffs in this docket.¹⁸⁷ However, to correct what Staff believes is an inadvertent error (the omission of a revision to Section 2) Staff would recommend that UNSE make that revision as a conforming change to its Rules and Regulations.¹⁸⁸

In the current case, UNSE proposed two additional modifications to its line extension tariff: (1) a Facilities Operation Charge to be imposed on line extension applicants under certain circumstances, and (2) a provision in the tariff specifying that up-front payments of estimated line extension construction costs will be treated as Contributions in Aid of Construction. In Direct

¹⁸² Ex. S-13 (Stewart Surrebuttal) at Executive Summary; Staff Final Schedule WCS H-1S.

¹⁸³ Ex. S-4 (Rozen Direct) at 3:6-8.

¹⁸⁴ Ex. S-4 (Rozen Direct) at 3:8-13.

¹⁸⁵ Ex. S-4 (Rozen Direct) at 3:14-18.

¹⁸⁶ Ex. S-4 (Rozen Direct) at 3:22-24; Staff Exhibit KCR-1.

¹⁸⁷ Ex. S-4 (Rozen Direct) at 3:25-26.

¹⁸⁸ Ex. S-4 (Rozen Direct) at 4:9-10; See also Decision No. 71285, ordering paragraph at page 4:9-10.

1 testimony Staff opposed the proposed Facilities Operation Charge.¹⁸⁹ In its rebuttal testimony,
2 however, the Company withdrew its request to implement the Facilities Operation Charge¹⁹⁰ and
3 agreed with Staff to remove the proposed language in its line extension tariff that would specify
4 accounting treatment for up-front payments received by the Company.¹⁹¹

5 Apart from UNSE's proposed revisions, Mr. Rozen explained that, because the Company's
6 rules should clearly state the required level of itemization the Company should provide, "Staff
7 recommends that Subsection 9.B.1.e be revised to provide that line extension agreements must
8 include a cost estimate to include itemized material costs, labor and other itemized costs as
9 necessary."¹⁹² Staff additionally recommends that the following sentence be added to Subsection
10 9.A.3: "The estimated costs provided to the applicant will be itemized."¹⁹³ As Mr. Rozen explained:

11 Staff believes UNSE should provide all Applicants with a sound basis for
12 understanding extension costs, including itemized materials costs, both as
13 estimated in the agreement and in the context of any adjustments necessitated
by the results of the Company's comparison between the estimated and actual
costs.¹⁹⁴

14 Itemizing this way will enhance an applicant's understanding of cost estimates. Additionally, Staff's
15 proposed addition is consistent with A.A.C. R14-2-207(B)(1).¹⁹⁵

16 In its rebuttal testimony, UNSE objected to Staff's recommendation regarding itemization of
17 estimated line extension costs, but after Staff maintained its recommendation in surrebuttal
18 testimony, the Company reluctantly agreed to Staff's recommended cost itemization revisions.¹⁹⁶

19 **2. Service Reconnection and Reestablishment Charges.**

20 In addition to the amounts provided for in Section 14 of its Rules and Regulations, the
21 Company originally proposed to require customers to pay the monthly customer charges that would
22 have accrued had service not been disconnected.¹⁹⁷ Staff opposes this proposal because (1)
23 significant charges are already authorized by Section 14 to recover the costs of service reconnection

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25 ¹⁸⁹ Ex. S-4 (Rozen Direct) at 6:4-7:25.

¹⁹⁰ Ex. S-6 (Rozen Surrebuttal) at 3:12-13.

¹⁹¹ Ex. S-6 (Rozen Surrebuttal) at 3:13-17; Ex. UNSE-9 (McKenna Rebuttal) at 1:26-27.

¹⁹² Ex. S-4 (Rozen Direct) at 9:15-21.

¹⁹³ Ex. S-4 (Rozen Direct) at 9:19-21.

¹⁹⁴ Ex. S-6 (Rozen Surrebuttal) at 5:13-17.

¹⁹⁵ Ex. S-6 (Rozen Surrebuttal) at 6:22-25.

¹⁹⁶ Ex. UNSE-10 (McKenna Rejoinder) at 2:9-14.

¹⁹⁷ Ex. UNSE-8 (McKenna Direct); Ex. S-4 (Rozen Direct) at 10:4-7.

1 and reestablishment and (2) UNSE should not collect any amount for services it did not provide to its
2 customers.¹⁹⁸ In its rebuttal testimony, the Company agreed with Staff to delete the language
3 allowing monthly minimums to be charged to customers whose service is reestablished or
4 reconnected.¹⁹⁹

5 **3. Undisputed Issues.**

6 Staff does not oppose UNSE's proposed revisions to Subsection 11.E to add language
7 specifying time frames for repaying and refunding under-billed and over-billed amounts resulting
8 from slow or fast meters, respectively.²⁰⁰ Staff also has no objections to the clarifying revisions
9 UNSE proposed throughout its Rules and Regulations.²⁰¹

10 **B. Independent Fuel And Purchase Power Audit.**

11 Staff recommends that periodic audits be conducted of the Company's procurement of fuel
12 and purchased power.²⁰² Staff makes this recommendation because the Company had no audit
13 reports issued in 2007 or 2008 related to fuel and purchased power procurement.²⁰³

14 **C. Listing Worst Performing Distribution Circuits In Annual Report.**

15 Staff recommends that the Company be ordered to provide a listing of the worst performing
16 circuits in an annual report of the distribution indices as well as a listing of steps being taken to
17 mitigate poor performing circuits.²⁰⁴ Staff further recommends that the report be separated by service
18 area as well as by the results for the overall UNS system.²⁰⁵ Additionally, Staff recommends that
19 other reporting requirements conform to those required of Arizona Public Service in the current
20 settlement proceedings.²⁰⁶ The Company argues that such a filing should not be ordered because
21 "circuits may appear at the top of the list for many reasons, some of which are not quickly or easily
22 mitigated."²⁰⁷ The Company also argues that "it may not be practical to address the worst circuits in
23

24 ¹⁹⁸ Ex. S-4 (Rozen Direct) at 10:19-24.

25 ¹⁹⁹ Ex. UNSE-9 (McKenna Rebuttal) at 8:16-22.

26 ²⁰⁰ Ex. S-4 (Rozen Direct) at 11:6-18.

27 ²⁰¹ Ex. S-4 (Rozen Direct) at 11:20-12:3; Ex. KCR-3 (attached to direct).

28 ²⁰² Ex. S-11 (Fish Surrebuttal) at 7:2-5.

²⁰³ Ex. S-11 (Fish Surrebuttal) at 7:1-5.

²⁰⁴ Ex. S-8 (Lewis Surrebuttal) at 3:13-17; Ex. S-7 (Lewis Direct) at 31:20-22.

²⁰⁵ Ex. S-7 (Lewis Direct) at 31:22-23.

²⁰⁶ Ex. S-7 (Lewis Direct) at 31:24-25.

²⁰⁷ Ex. UNSE-9 (McKenna Rebuttal) at 12:21-22.

1 order of performance because the underlying causes of poor performance may take significant time
2 and effort relative to other circuits.”²⁰⁸ However, as Mr. Lewis notes:

3 The distribution indices represent an average performance in the affected
4 service area or areas. If, in fact, some customers are experiencing much worse
5 outages, either in frequency or duration, then otherwise acceptable values of
6 indices are, or can be, misleading. A listing of the more poorly performing
7 circuits can indicate to what extent that is the case, and what measures could
8 be taken to mitigate the problems.²⁰⁹

9 Furthermore, Staff is aware of the Company’s concerns and “will not have any unreasonable
10 expectations as to the timing and nature of corrective actions.”²¹⁰

11 **D. Thermal Scanning.**

12 Although Staff recommends that UNSE conduct annual thermal scanning of the BMGS
13 substation, Staff does not believe that Commission must order the Company to do so. As Mr. Lewis
14 noted at the hearing,

15 My recommendation to any utility would be that they periodically use thermal
16 scanning to assist the reliability of their substation, switchyards and even
17 overhead lines on a regular basis. At the very minimum, prior to any purchase
18 or acquisition of Black Mountain Generating Station, the due diligence
19 evaluation should include this thermal scanning of the substation.²¹¹

20 The Company did not oppose Staff’s recommendation; they merely requested that the Company “be
21 allowed to determine the appropriate timing of any scan as part of its overall system maintenance.”²¹²

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24
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27 ²⁰⁸ Ex. UNSE-9 (McKenna Rebuttal) at 12:23-25.

²⁰⁹ Ex. S-8 (Lewis Surrebuttal) at 3:10-17.

²¹⁰ Ex. S-8 (Lewis Surrebuttal) at 3:19-24.

²¹¹ Tr. at 433:19-25.

²¹² Ex. UNSE-10 (McKenna Rejoinder) at 3:19-20.

1 **VI. CONCLUSION.**

2 For the reasons discussed above Staff recommends the Commission adopts its position in this
3 case, and reject the positions of the Company and RUCO, to the extent they conflict with Staff's
4 recommendations

5 RESPECTFULLY SUBMITTED this 23rd day of March, 2010.

6 

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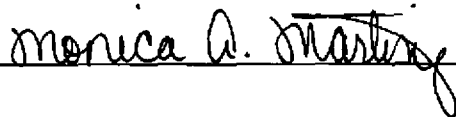
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